No. 09-870

IN THE

Supreme Court of the United States

AMANDA ARMSTRONG; HUI MIN ZHAO;
XIU ZHEN QI: MEN LIAN CHEN;
EDWARD LIEBERMAN; JOHN DOES,
Petitioner,

v.

COMMONWEALTH OF THE NORTHERN MARIANA ISLANDS; DEPARTMENT OF FINANCE,
Respondent,

On Petition for Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit

BRIEF FOR THE COMMONWEALTH OF THE NORTHERN MARIANA ISLANDS IN OPPOSITION

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ARGUMENT

The specific issues presented by Petitioner are:

1. Whether the Ninth Circuit err when it failed to find that the Northern Mariana Islands Territorial was federal law and thus associated local legislation and agency actions would raise federal questions;

2. Did the Ninth Circuit err when it failed to establish federal jurisdiction from the Covenant phrase "in the same manner as those laws are in force in Guam;"and

3. Did the Ninth Circuit err when it held that the CNMI legislature had authority to require that all disputes arising under the administration of the CNMI Mirror code must be brought exclusively in the CNMI Superior Court?

In support of these issues, eight arguments are presented:

1. The NMTIT is not federal law.

2. Decision in *Holmes v. Dir of Revenue & Taxation* does not support extension of federal jurisdiction in regards to NMTIT issues.

3. Prior extension of federal jurisdiction in Guam tax issues does not provide precedence for similar extension in the CNMI.

4. Decisions of Federal and Third Circuit regarding federal jurisdiction regarding insular area taxation does not support similar federal extension to the CNMI.

5. Covenant language stating that the tax structure is to be implemented "in the same manner as Guam" does not act to extend federal subject matter jurisdiction to CNMI tax issues.

6. The decision in *Olopai v. DeLeon Guerrero* and federal statutory language does not establish the Commonwealth's income tax rebate structure as based on federal law.

7. The Ninth Circuit opinion did not create a wholly local tax system not subject to federal review.

8. The Ninth Circuit decision in this case creates an unintended tax haven.

These arguments do not act to extend federal subject matter jurisdiction, and are examined in the sections that follow.

1. The NMTIT is not federal law

The first argument presented is that the NMTIT is federal law. In support of this position, the holding in *Preece v. Comm'r* and Commonwealth resident tax filing requirements are cited as authority. *Preece v. Comm'r*, 95 T.C. 594 (1990).

In *Preece,* the court examined whether residency in the Commonwealth for tax purposes was to be determined using a facts and circumstances test or substantial presence test. 95 T.C. at 594. The holding in *Preece* was that a facts and circumstances test, as established in federal regulations, was to be used. 95 T.C. at 609.

In support of the assertion that the Northern Mariana Territorial Income Tax (NMTIT) is federal law, Petitioner states that the court in *Preece*, "held that in accordance with I.R.C. § 935, as adopted by Covenant section 601(b), the CNMI Mirror code is federal law, not local law." Pet. App. 11. However, this is a misrepresentation, as the court in *Preece* made no such holding. 95 T.C. at 609-610. Additionally, the citation to authority in support of this position concerns unrelated factual background material and includes no discussion of whether the NMTIT is

federal or local law. Pet App. 11 (citation to 95 T.C. at 595).

Section 601 of the Covenant to Establish a Commonwealth of the Northern Mariana Islands in Political Union with the United States of America, Pub. L. 94-241, Act of Mar. 24, 1976; (reprinted at 48 U.S.C. § 1801 note), specifies that the appli cable United States Internal Revenue Code (IRC) provisions be enforced as *local* territorial laws (Covenant.) Pet. App. 44a (Ninth Circuit decision).

2. Decision in *Holmes v. Dir of Revenue & Taxation* does not support extension of federal jurisdiction in regards to NMTIT issues

The second argument of Petitioner is that the Ninth Circuit's decision declining to extend federal jurisdiction to Commonwealth tax claims conflicts with the previous decision rendered in *Holmes v. Dir. of Revenue & Taxation*, 827 F.2d 1243 (9th Cir. 1987). However, this argument indicates a misunderstanding of the decision of *Holmes*.

In Holmes, the court was considering the use of losses from a CNMI subchapter S corporation by Guam residents. 827 F.2d at 1243. In order to clarify application of the NMTIT subchapter S requirements to Guam taxpayers, the court applied the identical term substation guidelines contained in the Organic Act and the Covenant that are used to transform the language of the United States Internal Revenue Code (IRC) to a territorial income tax code. 4 CMC § 1701(e) (CNMI substitution of terms); 48 U.S.C. § 1421i(e) (Guam substitution of terms). Both of these standards provide for the substitution of various key terms in the IRC in order to transform it

from a United States statute to that of the respective territory (e.g. substitute the term "Guam" for "United States"). This structure for the conversion of the IRC to a territorial income tax structure by the use of substituted key terms is commonly referred to as the "mirror code." 827 F.2d at 1245.

Applying these standards, the court examined whether for purposes of applying the NMTIT, the commonwealth corporation would qualify for subchapter S election. 26 U.S.C. 1361(b). Upon determining that under the NMTIT Guam residents would not be considered nonresident aliens and a CNMI corporation would be considered domestic, the court determined that the subchapter S election was proper. 827 F.2d at 1245.[1,2]

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[1] In order to qualify for s corporation election, a corporation had to be a domestic corporation which does not have more than 75 shareholders; a shareholder who is not an individual; a nonresident alien shareholder; or more than one class of stock. 26 U.S.C. 1361(b).

[2] In applying the mirror code provisions of Guam and the CNMI, the court in Holmes developed a novel interpretation. Interpreting the language of Covenant section 601(c) which states "references in the Internal Revenue Code to Guam will be deemed also to refer to the Northern Mariana Islands" they determined that this meant that whenever the term Guam is used in the code it would *include* the term CNMI (*i.e.*, "Guam and CNMI") 827 F.2d 1245 (emphasis added). This approach is contrary to the provisions of both the CNMI and Guam which state that there should be a "substitution" not "addition." 4 CMC § 1701(e). Substitution more appropriately reflects the distinct taxing authority and legal structures of the two entities. However, in *Holmes*, the court properly states that the purpose of the mirror code provisions is to provide flexibility to avoid results that are absurd on their face or that lead to internal contradictions in the application of the Organic Code or Covenant. 827 F.2d at 1246.

In reaching this conclusion, the court decided to use an IRC mirror code interpretation standard in which wherever the term "Guam" was to be inserted, the term "CNMI" was also included. 827 F.2d at 1245. The court stated that this structure allowed for Guam residents to take advantage of the subchapter S structure of CNMI corporations and was not manifestly incompatible with the Covenant to Establish a Commonwealth of the Northern Mariana Islands in Political Union with the United States of America or the Guam Organic Code. 827 F.2d at 1245.

The decision in Holmes does not conflict with the Ninth Circuit's decision in Armstrong, or present substantial questions of federal law. Armstrong states that the Ninth Circuit decision precluding federal jurisdiction conflicts with the holding in Holmes that treated Guam and the CNMI as a common geographic entity. Pet. App. 13. However, these are distinct issues. In Holmes, the court was examining the tax liability of a Guam taxpayer and this required interpreting Commonwealth law. The court in Holmes was not extending jurisdiction over the CNMI. 827 F.2d at 1245. When the courts are applying the mirror code, flexibility is provided due to the complexity of the required manipulation of terms. 827 F.2d at 1245. The court felt that denial of the benefits provided by use of a CNMI subchapter S corporation did not undermine the distinct structure of these tax systems. 827 F.2d at 1245. However, the decision in Holmes was limited to a determination of the tax liability of a Guam resident for which United States law provides subject matter jurisdiction. 48 U.S.C. § 1421i(h). The decision in Holmes does not conflict with the decision of the Ninth Circuit which concerned establishment of Commonwealth Superior Court jurisdiction for the NMTIT.

3. The Ninth Circuit opinion does not conflict with its prior precedents holding that the federal courts have jurisdiction over matters arising out of the administration and enforcement of the Guam Mirror Code without a specific grant from Congress.

In support of the argument that subject matter jurisdiction to hear cases arising under the Guam Territorial Income Tax cases without a specific grant of authority from Congress, Armstrong cites the four cases of: *Laguana v. Ansell*, 102 F. Supp 919 (D. Guam 1952) *aff'd* by 212 F.2d 207 (9th Cir. 1954); *Holbrook v. Tuitano*, 125 F. Sup. 14 (D. Guam 1954); *Wilson v. Kennedy*, 123 F. Supp. 156 (D. Guam 1954), *aff'd* by 232 F.2d 153 (9th Cir. 1956); *Jennings v. United States*, 168 F.Supp. 781 (Fed. Ct. Cl. 1958). However, none of these cases discuss the jurisdiction of the District Court; and the subject matter jurisdiction of each one of these cases is established by United States law. All four of these cases involved federal courts interpreting Guam tax law.[3] 102 F.Supp. at 919; 125 F.Supp. at 14; 123 F.Supp. at 156; 168 F.Supp. at 781. In each case, federal subject matter jurisdiction is expressly provided by United States law. 48 U.S.C. § 1421i(h).

The Guam District Court was established under United States law with the adoption of the Guam Organic Act. 48 U.S.C. §1424(a)(1) (establishment of District Court of Guam); 48 U.S.C. § 1424(b)

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[3] The only jurisdictional issue discussed in the four case cited by Armstrong was the examination of the use of a three-judge panel to examine constitutionality of section 31 of the Organic Act. *Holbrook v. Taitano*, 125 F.Supp. 14, 17 (D.C. Guam 1954).

(District Court shall have broad original jurisdiction). The District Court of Guam was created under Article IV, § 3 of the United States Constitution rather than under Article III and was vested with broad original subject matter jurisdiction as identified in section 22 of the Guam Organic Act to provide initial legal structure for the territory. *Territory of Guam v. Olsen*, 431 U.S. 195, 196 (1977); 48 U.S.C. § 1424(b); 48 U.S.C. § 1424(c). As local courts were established, the United States allowed for a shifting of jurisdiction of the Guam District Court. 48 U.S.C. §1424(c). However, the United States Congress specifically confined subject matter jurisdiction in regards to civil and criminal matters associated with the Guam Territorial Income Tax to the Guam District Court. 48 U.S.C. § 1421i(h)(1); 48 U.S.C. § 1421i(h)(5); 431 U.S. at 197 (subject matter jurisdiction involving the Guam Territorial Tax has always been with the District Ct.).

Armstrong's citation to *Wilson* changes the nature of the argument presented from subject matter jurisdiction to the nature of the Guam Territorial Tax. Pet. App. 14-15. The specific language cited in *Wilson* concerns the interrelationship between the United States and Guam in the implementation of the United States tax laws. Pet. App. 14-15; 123 F.Supp at 159. In this cited section, the *Wilson* court is discussing how the income tax laws of the United States are adopted as local Territorial income taxes. 123 F.Supp at 159. The specific nature of the territorial tax depends on the legal structure used in its implementation and is different in each insular area. In Guam, reflective of its history as a United States Possession, the imposition of the Territorial Income Tax is done completely under United States law although this law provides authority for collection by

the local government. 48 U.S.C. § 1421i (establishment of Guam Territorial Income Tax); 48 U.S.C. § 1421i(c) (establishment of local administration); 48 U.S.C. § 1421i(e) mirror code provisions); 48 U.S.C. § 1421i(h) (jurisdiction of District Court for tax issues); 48 U.S.C. § 1421i(h)(5) (limits transfer of tax jurisdiction). In contrast, in the Commonwealth the agreement to establish the United States income tax is established in the Covenant, but is implemented exclusively through local law. Covenant, Art. VI, § 601(a)-(c); 4 CMC § 1701 (a) (IRC adopted as NMTIT), 4 CMC § 1701(e) (mirror code provisions); 4 CMC § 1702 (adoption of IRC).

It is not contested, that in both Guam and the CNMI the United States Internal Revenue Code has been adopted in such a manner that any changes to the IRC are automatically adopted by the respective insular areas. Furthermore, all of the insular areas are limited in the changes they can make to the Internal Revenue Code. *Government of Guam v. Koster*, 362 F.2d 248, 251 (9th Cir. 1966) (limits on changes to I.R.C.); *Chase Manhattan Bank, NA v. Government of the Virgin Islands*, 300 F.3d 320, 322 (3rd Cir. 2002) (limits on changes to I.R.C.). However, the method provided for adoption of the IRC can directly control its subject matter jurisdiction and this was reflected in the decision of the Ninth Circuit. In the CNMI, the Commonwealth specifically required that the IRC be adopted as a local territorial income tax subject to local court jurisdiction and this is reflected in its legal structure.

Contrary to the third argument of Armstrong, there is no conflict with the decision of the Ninth Circuit and cases deciding administration and enforcement of the Guam Territorial Income Tax.

4. The Ninth Circuit's decision holding the CNMI Mirror code to be adopted under the authority of the local possession does not conflict with decisions from the Third and Federal Circuit's holding that federal law is the source of authority for the Mirror code systems

Armstrong's argument that the Ninth Circuit's decision contradicts decisions of the Third and Federal Circuit indicates a misunderstanding of the legal structures of the Territories of Guam and the United States Virgin Islands.

In support of this position, Armstrong cites the three Third Circuit decisions of: *Chicago Bridge and Iron Company v. Wheatly*, 430 F.2d 973 (3rd Cir. 1970); *HMW Industries, Inc v. Wheatley*, 504 F.2d 146 (3rd Cir. 1974); and *Vitco v. Government of the Virgin Islands*, 560 F.2d 180 (3rd Cir. 1977). Armstrong states that the decisions in these cases show that there is "no ambiguity as to whether matters arising the Virgin Islands territorial income are matters of federal law supporting federal questions subject matter jurisdiction in the district court of the possession." Pet. App. 16. However, federal subject matter jurisdiction for causes arising under the Virgin Islands Territorial Income Tax has never been questioned, as it is specifically addressed in United States law. 48 U.S.C. § 1612. Under the Revised Organic Act of the Virgin Islands, the District Court of the Virgin Islands "shall have exclusive jurisdiction over all criminal and civil proceedings in the Virgin Islands with respect to the income tax laws applicable to the Virgin Islands."

Armstrong's argument that the Federal Circuit decision of *Bank of Guam v United States*, 578 F.3d 1318 (Fed. Cir. 2009) is in conflict with the decision of the Ninth Circuit is not clear. Armstrong states that the holding in *Bank of Guam* is that Guam merely "administers the income tax laws of the United States at the direction of the United States and not the possession or territory." Pet. App 17. Armstrong uses the holding in *Bank of Guam* to support the position that "federal law is the source of authority for the [m]irror [c]ode systems" and that this conflicts with the decision of the Ninth Circuit. Pet. App.17.

However, this argument misunderstands the holding of the Ninth Circuit. Like the statements made by the court in *Bank of Guam*, the Ninth Circuit decision recognized that the United States income tax laws were the foundation for the NMTIT. Pet. App. 36a. However, the Ninth Circuit distinguished the tax structures of Guam and the CNMI by the legal structures used in the adoption of the respective income tax systems. Pet. App. 43a-45a.

In Guam, the territorial income tax structure is established completely under United States law. The mirror code system, administrative structure, and subject matter jurisdiction are all established under United States law. 48 U.S.C. § 1421i(a); 48 U.S.C. § 1421i(b) (establishment of Guam Territorial Income Tax); 48 U.S.C. § 1421i(c) (administration of Guam Territorial Income Tax); 48 U.S.C. § 1421i(e) (mirror code structure); 48 U.S.C. § 1421i(h) (exclusive subject matter jurisdiction of District Court of Guam). Under this structure, the Guam Territorial Income Tax is controlled by United States law, and specific statutory language retained exclusive subject matter jurisdiction within the federal court. 48 U.S.C.

§ 1421i(h) (exclusive subject matter jurisdiction of District Court of Guam).

In contrast, the Commonwealth of the Northern Mariana Islands has established the structure of the territorial income tax under Commonwealth law as provided for by the Covenant. 4 CMC § 1701(a) (adoption of United States Internal Revenue Code as the Northern Marianas Territorial Income Tax); (b) (administration and enforcement of the NMTIT); (c) (authority of the Governor); (e) (establishment of mirror code system). Subject matter jurisdiction for all causes arising under the NMTIT is specifically established by Commonwealth law in the Superior Court of the Northern Mariana Islands. 4 CMC § 1701(e). Using the authority provided in the Covenant, the Commonwealth established the NMTIT as a local law, and retained subject matter jurisdiction within its courts.

The holdings of the Third and Federal Circuit cited by Armstrong are consistent with the decision in the Ninth Circuit. The differences in these holdings reflect the different legal structures provided for the territorial income tax structures of Guam, the United States Virgin Islands, and the CNMI.

5. Covenant Section 601's directive that the Mirror code system in the CNMI will be "in force" in the "same manner as Guam" does not extend subject matter jurisdiction to the CNMI district court

Armstrong's fifth argument in support of the position that the Ninth Circuit position was in error is that the meaning of the Covenant section 601(a) phrase "in force . . . in the same manner as those laws are in force in Guam," extends subject matter jurisdiction to the CNMI district court.

The issue of the meaning of the phrase referring to how the territorial income tax is enforced in Guam is a reoccurring issue. Since the Covenant is a United States Statute, it is appropriate that standards of statutory interpretation be used to clarify its meaning. 48 U.S.C. § 1801 note. Statutory interpretation requires that one must first examine the plain meaning of the language used and absent a clearly expressed legislative intent to the contrary, that language must be regarded as conclusive. *Consumer Product Safety Commission v. GTE Sylvania, Inc.*, 447 U.S. 102, 108 (1980). In expounding a statute, you are not guided by a single sentence or member of a sentence, but look to the provisions of the whole law, its objective, and policy. *United States National Bank of Oregon v. Independent Insurance Agents of America, Inc.*, 508 U.S. 439, 455 (1993). Plainness or ambiguity of statutory language is determined by reference to: the language used; specific context in which language is used; and the broader context of the statute as a whole. *Robinson v. Shell Oil Co.*, 519 U.S. 337, 341 (1997).

To determine the meaning of the statutory phrase "same manner as those laws are in force in Guam," we look to the plain meaning of the words used, its context and objective. *Consumer Product Safety Commission v. GTE Sylvania, Inc.*, 447 U.S. 102, 108 (1980); *United States National Bank of Oregon v. Independent Insurance Agents of America, Inc.*, 508 U.S. 439, 455 (1993). The statutory phrase referring to Guam concerns adoption of the United States Internal Revenue Code as a Northern Mariana Territorial Income Tax. Covenant, Art. VI § 601. In order to accomplish the objective of converting a United States tax structure to a local territorial tax requires that certain terms be substituted to bring these laws

"into force in the Northern Mariana Islands as a local territorial income tax." Covenant, Art. VI § 601(a). The territory of Guam used a substitution of terms to bring their income tax structure "*in force in Guam.*" 48 U.S.C. § 1421i(e) (substitution of terms)(emphasis added). "In the same manner as [these] laws are in force in Guam," the Commonwealth adopted a plan for the substitution of terms. 4 CMC § 1701(e). Under the terms of this structure:

> (e) In applying the NMTIT for any purpose contained within this division, except where it is manifestly otherwise required, the applicable provisions of the I.R.C. shall be read so as to substitute Commonwealth of the Northern Mariana Islands for United States, Governor or his delegate for Secretary or his delegate, Governor or his delegate for Commissioner of Internal Revenue and Collector of Internal Revenue, Superior Court of the Northern Mariana Islands for district court, Supreme Court of the Northern Mariana Islands for United States Courts of Appeal, Attorney General for district counsel, Attorney Generals Office for Department of Justice, and with other changes in nomenclature and other language, including the omission of inapplicable language, where necessary to effect the intent of this chapter.

4 CMC § 1701(e). The plain meaning of the phrase, "*as those laws are in force in Guam*," when examined in terms of its context and policy objective supports a finding that this refers to implementation of a substitution of terms structure that would allow "[t]he income tax laws *in force* in the United States [to] come *into force* in the Northern Mariana Islands as a local territorial income tax . . . in the same

manner as those laws are *in force* in Guam." Covenant Art. VI § 601 (emphasis added).

In contrast to the use of statutory standards of interpretation to determine the meaning of the phrase "in force . . . in the same manner as those laws are in force in Guam," Armstrong relies on a combination of five different extrinsic aids: 1) contemporary analysis; 2) 1983 Congressional report; 1985 federal commission findings; and 5) case law. Pet. App. 19-21. The documents cited by Armstrong agree that the phrase at issue refers to use of the mirror code structure to transform the United States Internal Revenue Code to a territorial income tax structure.[4] The one document provided by Armstrong that addresses the issue of subject matter jurisdiction is a 1985 study produced by the Northern Mariana Island Commission on Federal Law to the Congress of the United States (hereinafter "Commission Study). *Welcoming America's Newest Commonwealth-The Second Interim Report of the Northern Mariana Islands Commission on Federal Laws to the Congress of the United States* (August 1985). Pet. App. 20. This document states, "[t]he District Court for the Northern Mariana Islands has civil and criminal

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[4] The first document cited by Armstrong, The *Section by Section Analysis of the Covenant to Establish a Commonwealth of the Northern Mariana Islands*, was prepared by the Marianas Political Status Commission in 1975 and is generally considered as a valid source for interpretation of the Covenant. This analysis agrees that the phrase "into force . . . in the same manner as those laws are in force in Guam," references the mirror code structure. *Section by Section Analysis of the Covenant to establish a Commonwealth of the Northern Mariana Islands,* 67-68 (Marianas Political Status Commission 1975) (hereinafter "Covenant Analysis"). However, the issue of subject matter jurisdiction over tax issues is not discussed.

jurisdiction over disputes involving the local territorial income taxes of the Northern Mariana Islands" Commission Study at 436; Pet. App. 20. The shortcoming of this source is that it cites Guam law for authority. Citation to Guam law is improper when controlling law is established by the Commonwealth. During the period from January 1, 1985 through January 1, 1995, the Commonwealth provided the District Court of the Northern Mariana Islands with subject matter jurisdiction over Northern Mariana Territorial Income Tax matters. CNMI P.L. 4-24 (provides subject matter jurisdiction for tax to District Court); P.L. 9-22 (transfers subject matter jurisdiction for the NMTIT from District Court to CNMI Superior Court). Citation to invalid authority undermines Armstrong's argument that subject matter jurisdiction is vested in the District Court of the Mariana Islands.[5] Pet. App. 20.

Thus, the documents Armstrong cites, are in agreement with the plain meaning interpretation of this statutory phrase, "in force . . . in the same manner as those laws are in force in Guam" implies application of the mirror code. Covenant Art. VI, § 601(a). Commonwealth law provided the structure for application of the mirror code and this dictates that subject matter jurisdiction for tax issues in the Northern Mariana Islands Superior Court. 4 CMC § 1701(e). Armstrong's sole reference to District

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[5] Armstrong cites the holding in the case of *Preece v. Comm'r* for the position that the court, "clearly employed the analysis as what the Covenant Section 601 meant by the phrase "same as Guam." Pet. App. 20; 95 T.C. 594. However, in *Preece*, the only reference to the phrase "same as Guam" is a brief discussion stating that in interpreting section 601(a) of the Covenant, one should substitute the word CNMI for the United States where appropriate. 95 T.C. at 598.

Court jurisdiction over tax claims is based on improper authority.

6. Ninth Circuit panel did not misquote the District Court in another case that arose under 48 U.S.C. § 1843 (c)

In this sixth argument, Armstrong takes the position that income tax rebates provided by the Commonwealth are authorized by federal law and that violation of these laws provides federal subject matter jurisdiction. Pet. App. 21-23. In support of this position, Armstrong cites the federal statute which requires that the Commonwealth rebate system requires prior payment of taxes. Pet. App. 21; 48 U.S.C. § 1843.

The Commonwealth tax rebate system, like the NMTIT is a combination of federal and local law. Authority to grant rebates from the NMTIT is established in the Covenant which states that this shall be done under "local law." Covenant, Art. VI § 602 (government may provide rebate of any taxes received). Local law establishes taxpayer entitlements to rebates and program structure. 4 CMC § 1708. Thus, like the NMTIT, authority for granting of rebates is provided by the Covenant, but structured to be done through Commonwealth law. Covenant, Art. VI, § 602; 4 CMC § 1708. This is the position identified by the Ninth Circuit.

Armstrong argues that this position conflicts with the congressional intent in the adoption of 48 U.S.C. § 1843[6] and the decision in *Olopai v. DeLeon*

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[6] Armstrong's citation to authority (note 23) is incorrect. The proper citation should be to 129 Cong. Rec. H7861 (daily ed. October 3, 1983).

Guerrero, 1993 U.S. Dist Lexis 13839 (D.N.Mar.I. Sept 24, 1993); Pet. App. 21-23. These two issues are examined below.

Armstrong's first issue in her sixth argument concerns statements made by the court in *Olopai v. De Leon Guerrero*, 193 U.S. Dist. LEXIS13839 (D.N. Mar. I. Sept.. 24 1993) (hereinafter *Olopai*). Pet. App. 22. In this argument, Armstrong states that the "Ninth Circuit misquotes *Olopai*." Pet. App. 22. However, the Ninth Circuit decision only cited *Olopai* for the provision of background information regarding the tax structure of the CNMI. Pet. App. 36a, 41a. In contradiction to her argument, Armstrong does not contest the background citations to *Olopai* provided by the Ninth Circuit, and instead goes on at length concerning issues in *Olopai* that were not cited. Pet. App. 22.

The specific section of *Olopai* cited by Armstrong in this new argument concerns whether the disclosure provisions of P.L. 98-213 violate the Covenant. Pet. App. 22.[7] P.L. 98-213 concerned United States law which required public disclosure of rebate information. *Olopai* at 1. The position of the CNMI was that under section 602 of the Covenant, rebates were to be controlled by local law and thus any federal requirements were an infringement of the right to self-government established by Covenant sections 103 (self-government) and 105 (mutual consent). *Olopai*, at 12. The court stated that under terms of sections 101 (U.S. sovereignty) and 102 (supremacy clause) the United States had authority to enact

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[7] Armstrong's citation to the appropriate section in *Olopai* (*i.e.*, *Olopai* at 10) is in error as the cited section should read, *Olopai* at 11.

appropriate legislation. *Olopai,* at 12. However, in order to determine if U.S. legislation improperly infringed on the right to self-government, a test was required which balanced the interest of the United States in monitoring the Commonwealth's use of the local rebate structure against the degree of intrusion in local affairs. *Olopai,* at 12. The court found that the federal interest in monitoring this local rebate program was significant and the intrusion on self-government was appropriate and justified. *Olopai*, at 12-13.

Armstrong's use of the discussion of the *Olopai* court's discussion of U.S. sovereignty and the supremacy clause as contained in the Covenant are unclear. The Ninth Circuit decision is consistent with the holding in *Olopai* in that the United States and the Commonwealth each have their respective areas of responsibility in the implementation of the tax structure. The Ninth Circuit decision does not conflict with the *Olopai.*

Armstrong's final sixth argument component concerns the legislative history surrounding the adoption of 48 U.S.C. § 1843. Pet App. 23. This United States statute concerns initial implementtation of the NMTIT. 129 Cong. Rec. H7861 (daily ed. October 3, 1983). Congress had initially requested an implementation of the NMTIT by January 1, 1979. 129 Cong. Rec. H7861 (daily ed. October 3, 1983). However, Commonwealth residents were concerned about the new pending tax liability and local legislators proposed that the rebate system be structured to be a tax abatement system where tax liability associated with Commonwealth source income would be abated instead of rebated. 129 Cong. Rec. H7861 (daily ed. October 3, 1983). In an abatement structure, the tax

liability was waived without payment. 129 Cong. Rec. H7861 (daily ed. October 3, 1983). In a rebate structure, tax liability had to be paid prior to return (rebate) by the government. 129 Cong. Rec. H7861 (daily ed. October 3, 1983). The United States felt that an abatement system would undermine the United States Internal Revenue Code Structure, and in subsequent negotiations, the Commonwealth agreed to maintain a rebate structure. 129 Cong. Rec. H7861 (daily ed. October 3, 1983). This negotiated transition plan provided for a waiver of tax liability on Commonwealth source income for the first three years of implementation of the NMTIT. Due to the limited ability of the Commonwealth to amend the substantive provisions of the IRC, this waiver had to be provided by United States law. 129 Cong. Rec. H7861 (daily ed. October 3, 1983). This United States transition program also restricted the use of the authorized rebate program by providing a definition that precluded abatement. 48 U.S.C. 1843(c).

Contrary to the argument of Armstrong, the legislative history illustrates the mixture, and limits, of United States and Commonwealth law. Under United States law, the tax structure is provided, however Commonwealth law is used to implement, enforce and establish tax liability. Covenant; Art. VI § 601; 4 CMC § 1701(a)-(e). This legislative history is consistent with the Ninth Circuit's decision.

7. The Ninth Circuit opinion did not create a wholly local tax system not subject to federal review

The seventh argument raised by Armstrong in support of extension of federal subject matter jurisdiction over NMTIT issues is based on the assertion that "[t]he Ninth Circuit's opinion permits the CNMI to have a wholly local tax system not subject to federal review without going through the process that Congress requires for Mirror code possessions to delink." Pet. App 24. This argument is based on federal law that was adopted in 1986 which allows territorial governments to be excluded from use of the United States Internal Revenue Code by adoption of alternative tax structures.[8] Joint Committee on Taxation, General Explanation of the Tax Reform Act of 1986, H.R. 3833, 99th Congress, P.L. 99-514 (hereinafter "Joint Committee").

This legislation had several objectives. It was recognized that the imposition of the complex United States income tax structure on small undeveloped isolated communities posed a significant burden. Joint Committee at 118. Additionally, the ever changing tax laws overwhelmed island tax officials. Joint Committee at 118. Furthermore, the United States tax structure was inappropriate for communities with high proportion of lower income individuals. Joint Committee at 118. Finally, it was felt that island tax structure had to be more responsive to

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[8] The provision of alternative tax structures to the United States Internal Revenue Code for the Insular areas was based on the difficulty of administering this complex tax structure by governments with extremely limited resources. Joint Committee at 1118.

the particular economic needs of the community. Joint Committee at 118.

Although the United States understood the problems associated with use of the IRC in small communities, it had concerns that by eliminating its use would create tax havens. Joint Committee at 118. In order to address this concern, the United States coupled the authority to drop the required use of the Internal Revenue Code with significant oversight and alternative requirements. Joint Committee at 118. These requirements varied by each insular area, but generally included increased monitoring by the United States, maintenance of revenues, and coordination with U.S. tax policies. The limited resources of the insular area tax authorities and apprehension about changing from an accepted United States standard have prevented any of the insular areas from implementing these alternative tax structures.

Armstrong's argument regarding the alternative tax structures contained in the Tax Reform Act of 1968 are unclear. It is assumed that the Armstrong argument is that by prohibiting federal subject matter jurisdiction, the Ninth Circuit has created an alternative tax structure in the Commonwealth in violation of the requirements of the Tax Reform Act of 1968. App. Pet. 24. However, this is an unsubstantiated claim totally unsupported by facts.

The Commonwealth coordinates its tax structure and administration with the United States Internal Revenue Service. 4 CMC § 1701 through 4 CMC § 1713. All Commonwealth taxpayers are required by law to fully comply with all applicable elements of the United States Internal Revenue Code adopted by the NMTIT. 4 CMC § 1701 through 4 CMC § 1713.

The CNMI uses the same forms, procedures, and legal structure of the United States Internal Revenue Code. 4 CMC § 1701 though 4 CMC § 1713. Additionally, the Commonwealth has adopted the same criminal and civil penalty structure of the United States and actively places liens and levies on delinquent taxpayers.

The Commonwealth tax structure is subject to numerous limits and reviews to ensure the coordination of Commonwealth and United States tax systems. These limits include: residency requirements; special sourcing rules; and taxpayer information exchanges. 26 U.S.C. § 935; 26 CFR §§ 1.931-1 through 1.937-3 (special sourcing rules). These special Internal Revenue Regulations all act to restrict and control the application of the United States tax laws in the Commonwealth. Additionally, the Commonwealth adheres to the limitation that it may only make changes in the Internal Revenue Code that are required to address items that are manifestly incompatible with the intent of the specific section of the Internal Revenue Code. 4 CMC § 1701(h); *Government of Guam v. Koster*, 362 F.2d 248, 251 (9th Cir. 1966) (limits on changes to I.R.C.); *Chase Manhattan Bank, NA v. Government of the Virgin Islands*, 300 F.3d 320, 322 (3rd Cir. 2002) (limits on changes to I.R.C.)

Armstrong's claim that the decision of the Ninth Circuit has created an unregulated tax haven in the CNMI conflicts with the ongoing administration and enforcement of the NMTIT, and is without merit.

8. The Ninth Circuit's Decision in this Case creates an unintended tax haven

In Armstrong's final argument it is asserted that the Ninth Circuit's decision will lead the creation of a U.S. tax haven in the Commonwealth. This argument is similar to that asserted in argument seven and should be similarly dismissed.

Armstrong's assertion that the Commonwealth will become a tax haven is made without factual or legal support. Furthermore, many of the claims made by Armstrong are incorrect. First, Armstrong's claim concerning rebates fails to identify that only Commonwealth source income is subject to rebates. 4 CMC § 1708. Second, there are significant limits on the application of the NMTIT that ensure compliance with the intent of Article VI of the Covenant including residency requirements; sourcing rules; and limits on changes to Internal Revenue Code language. 26 U.S.C. §§ 935 (residency and filing requirements), 26 U.S.C. § 937 (residency); 26 CFR § 1.931-1; through 26 CFR § 1.937-3 (special sourcing rules). Third, the Covenant specifically authorizes the Commonwealth to provide rebates based on Commonwealth sourced income. Covenant art. VI § 602. Fourth, language in the Covenant and the NMTIT specifically limit any changes to the Internal Revenue Code that would alter the intent of the statutes. 4 CMC § 1701(h); *Government of Guam v. Koster*, 362 F.2d 248, 251 (9th Cir. 1966) (limits on changes to I.R.C.); *Chase Manhattan Bank, NA v. Government of the Virgin Islands*, 300 F.3d 320, 322 (3rd Cir. 2002) (limits on changes to I.R.C.). Armstrong's argument that the CNMI has used its authority over the NMTIT to alter the date interest accrues on refunds is incorrect as the statute she

refers to concerns the date for allowance of tax rebate offset. (Pet at 26); 4 CMC § 1711(b) (rebate offset procedure). Fifth, there is no history of the Commonwealth being used as a tax haven; in fact the opposite is true as the Commonwealth and the United States have specifically adopted rules that restrict residency and the associated tax privileges. 26 U.S.C. § 935; 26 U.S.C. § 937; 26 CFR § 1.931-1 through 26 CFR § 1.937-3 (special sourcing rules). Finally, the Commonwealth is an undeveloped small, isolated, community with a high degree of poverty, lack of infrastructure, and small population (under 60,000) dispersed among 14 islands, and there is not a documented need or legal foundation for the extension of federal jurisdiction into this small local tax system.

CONCLUSION

For the reasons cited above, the petition for the writ of certiorari should be denied.

Respectfully submitted.

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